

# Oversight Division

Committee On Legislative Research

## **PROGRAM EVALUATION PROFESSIONAL ATHLETES AND ENTERTAINERS TAX**

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# Program Evaluation Professional Athletes and Entertainers Tax

*Prepared for the Committee on Legislative Research  
by the Oversight Division*

*Mickey Wilson, CPA, Acting Director  
Review Team: Steve Shiery, CPA, Team Leader, Wayne Blair, Matt Funke, CPA*

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## Committee on Legislative Research Oversight Subcommittee

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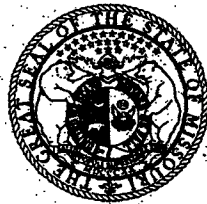
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STATE CAPITOL  
JEFFERSON CITY, MISSOURI 65101-6806

January 30, 2002

Members of the General Assembly:

The Joint Committee on Legislative Research adopted a resolution in May, 2001, directing the Oversight Division to perform a program evaluation of the Athletes and Entertainers Tax Program to determine and evaluate program performance in accordance with program objectives, responsibilities, and duties as set forth by statute or regulation.

The accompanying report includes Oversight's comments on internal controls, compliance with legal requirements, management practices, program performance and related areas. We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates.

Respectfully,

A handwritten signature in cursive script that reads "Larry Rohrbach".

Senator Larry Rohrbach  
Chairman

## EXECUTIVE SUMMARY

The Missouri General Assembly passed Senate Bill 477 in 1994, creating an earmarked revenue stream for the Missouri Arts Council. Senate Bill 477 required the Commissioner of Administration to prepare an annual estimate of state income taxes collected from nonresident members of professional athletic teams and nonresident entertainers. For fiscal year 1996 and for each subsequent year for a period of nine years, an amount equal to fifty percent of the estimated revenues was to be transferred from the General Revenue Fund to the Missouri Arts Council Trust Fund. In 1998, the Missouri General Assembly passed Senate Bill 724, which extended the time covered by the program through 2008, and provided for a two percent withholding on all contracts with nonresident entertainers. Senate Bill 724 also increased the annual transfer to the Missouri Arts Council Trust Fund to sixty percent of estimated revenues. Senate Bill 724 further directed ten percent of estimated revenues to be transferred to each of the following; the Missouri Humanities Council Trust Fund, the Missouri State Library Networking Fund, the Missouri Public Television Broadcasting Corporation Special Fund, and the Missouri Department of Natural Resources Missouri Historic Preservation Revolving Fund. The Department of Revenue collects and reports the required taxes and administers the program, and the Office of Administration estimates revenues and makes the transfers among the various funds. The amounts transferred under the program were as shown on Schedule 1.

The Department of Revenue has imposed significant restrictions on the availability of tax and other data to the Oversight Division and other outside organizations. Based on its interpretation of Section 32.057 RSMo, the Department denied Oversight staff access to any information which could potentially identify individual taxpayers. Because of this restriction on access to relevant information, Oversight's review was limited to analysis of Department of Revenue compilations of tax collections reported for this program and discussion with Department of Revenue employees. Accordingly, no review or testing of actual data was performed and Oversight is unable to provide assurance as to the Department of Revenue's reported totals. Oversight prepared an estimate of expected collections from the program based on public sources of information. This estimate indicates revenues reported by the Department of Revenue and transfers made by the Office of Administration were substantially understated.

The Office of Administration has failed to prepare annual estimates of tax collections as required by statute. Office of Administration officials told us one formal estimate was prepared in 1996, but no documentation could be located to support that estimate of revenues. We were told the same estimate, adjusted for estimated revenue growth, was used to determine transfers made from 1996 to 2001, but no documentation of estimates was provided for these years. An adjustment was made to reduce the amount transferred for 2002, but no independent documentation existed to support that adjustment and the resulting change in the amounts transferred. Office of Administration staff told us the adjustment was based on collections reported to them by the Department of Revenue.

Reported tax collections in this program were less than expected. Oversight believes there were three major factors in this shortfall. First, athletes assigned to Missouri teams were incorrectly assumed by the Department of Revenue and the Office of Administration to be Missouri residents. Second, tracking and accumulating of tax collections was inconsistent and incomplete. Third, contracts executed between the Department of Revenue and the professional sports leagues appeared to provide a special tax rate for professional athletes, release most professional athletes from filing state income tax returns, and to release athletes, teams, and leagues from potential tax liabilities for the current and prior seasons.

Amounts transferred for the benefit of the programs designated in Senate Bills 477, 1994, and Senate Bill 724, 1998, have been significantly less than estimated in the preparation of the fiscal notes for the legislation. The inability of Oversight staff to review actual tax data prevents a determination of the factors in this variation other than those noted above.

Overall, Oversight recommends the Department of Revenue and Office of Administration implement controls and procedures to assure collections from nonresident professional athletes and entertainers are correctly withheld, assessed and paid, accurately reported, and transferred to the designated organizations as required by statute. Oversight specifically recommends the Department of Revenue advise taxpayers to file returns and pay taxes as required by state law. Oversight also recommends consideration of changes to the Department of Revenue confidentiality law to provide for an independent review of the Department's operations.

The Oversight Division did not audit department or divisional financial statements and, accordingly, does not express an opinion on them.

A handwritten signature in black ink that reads "Mickey Wilson". The signature is written in a cursive, flowing style.

Mickey Wilson, CPA  
Acting Director, Oversight Division

# **Chapter One - Introduction**

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## **Background**

The taxation of professional athletes and entertainers is administered within the Department of Revenue (DOR), Division of Taxation and Collection. Identification and taxation of professional athletes and entertainment figures was a priority for the department in previous years, when the methodology and underlying data regarding professional sports and entertainment were developed. DOR employees maintain communications with professional sports leagues and teams, and contract with those leagues for reporting taxable income and withholding personal income taxes from professional athletes. Beginning in 1998, Senate Bill 724 added a requirement for entertainment venues to deduct and remit to the Department of Revenue a two percent withholding on contracts with nonresident entertainers. DOR employees maintain records of entertainment venues in the state, and provide information regarding the Entertainer's Tax withholding program to those venues. Personal and corporate income tax returns for professional entertainers and professional athletes are processed within the Division of Taxation and Collection.

Senate Bill 477 required the Commissioner of Administration to prepare an annual estimate of state income taxes collected from nonresident members of professional athletic teams and nonresident entertainers. For fiscal year 1996 and for eight subsequent years, the Commissioner of Administration was required to transfer fifty percent of those estimated revenues from the general revenue fund to the Missouri Arts Council Trust Fund. In 1998, Senate Bill 724 extended the transfer requirement through 2008, and increased the annual transfer to the Missouri Arts Council Trust Fund to sixty percent of estimated revenues. Senate Bill 724 further directed the Commissioner of Administration to transfer ten percent of estimated revenues to each of the following; the Missouri Humanities Council Trust Fund, the Missouri State Library Networking Fund, the Missouri Public Television Broadcasting Corporation Special Fund, and the Missouri Department of Natural Resources Missouri Historic Preservation Revolving Fund.

## **Purpose**

The General Assembly has provided by law that the Committee on Legislative Research may have access to and obtain information concerning the needs, organization, functioning, efficiency and financial status of any department of state government or any institution that is supported in whole or in part by revenues of the state of Missouri. The General Assembly has further provided by law for the organization of an Oversight Division of the Committee on Legislative Research and, upon adoption of a resolution by the General Assembly or by the Committee on Legislative Research, for the Oversight Division to make investigations into legislative and governmental institutions of this state to aid the General Assembly.



The Committee on Legislative Research directed the Oversight Division to perform a program evaluation and expenditure review for the purpose of providing information to the General Assembly regarding proposed legislation and appropriation bills.

## **Objectives**

The program evaluation of Athletes and Entertainers Tax did not include the inspection of records due to the scope limitation described in the Executive Summary. Due to the scope limitation, certain objectives could not be addressed. Instead, Oversight interviewed employees of the Department of Revenue and the Office of Administration, and calculated an estimate of program collections using data available to the public. The Oversight Division's evaluation focused on the objectives noted below.

- Overlap of new nonresident entertainer law with other tax laws;
- Benefits of new withholding law;
- Other state laws;
- Receipts sent to Missouri Arts Council;
- Formula used to compute the amount sent to the Missouri Arts Council;
- Trends in collections and reasons for those trends;
- DOR performance measures.

## **Scope/ Methodology**

Our evaluation included interviews with Department of Revenue and Office of Administration employees, surveying entertainment venues, and compiling financial information regarding professional athletes and entertainers.

Our scope was not limited to any specific years, although most analyses were performed using information from 1998 through 2000.

## Chapter Two - Chart

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Our report includes a chart of estimated Athletes and Entertainers Tax revenues for fiscal years 1997 through 2002. The chart indicates collection amounts estimated by the Office of Administration and transferred for the benefit of the organizations designated in Senate Bill 477 and Senate Bill 824, and the corresponding collections reported by the Department of Revenue. For comparison purposes, the chart also includes amounts Oversight calculated based on publicly available information. Actual collections were not determined due to the scope limitation discussed in the Executive Summary.

	DOR Collections Reported	Appropriation Transfer	Oversight Estimate of Revenue - Low	Oversight Estimate of Revenue - High
FY 1997	2,825,365	4,450,000	6,700,000	8,800,000
FY 1998	3,651,587	4,528,383	7,700,000	9,400,000
FY 1999	3,855,810	7,022,395	8,800,000	10,100,000
FY 2000	3,703,509	8,497,776	10,100,000	10,800,000
FY 2001	4,639,906	8,656,768	10,900,000	12,400,000
FY 2002	n/a	4,639,908	11,800,000	14,300,000

Note 1: The tax year (January - December) has been matched with the fiscal year immediately following (July - June)

Note 2: Transfers were to be 50% of the estimate (to the Arts Council ) before FY 2000.

For FY 2000 and later, 100% of the estimate was to be transferred.

For FY 2000 and later, 60% of the total was to be transferred to the Arts Council.

Note 3: In September, 2001 the Governor vetoed certain transfer amounts, reducing transfers for FY 2002 to \$4,328,382.

## Chapter Three - Comments

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### **Comment 1:**

**The Office of Administration failed to prepare an annual estimate of state income tax received from nonresident athletes and entertainers.**

The Office of Administration has failed to prepare an annual estimate of state income tax received from nonresident athletes and entertainers as required by state law. An estimate was prepared in 1996 based on the incorrect assumption that athletes assigned to Missouri teams were Missouri residents. That estimate, with modest annual increases, was used for transfers from 1997 through 2001. A second estimate prepared in 2001 for 2002 transfers was based on collections reported by the Department of Revenue. As discussed elsewhere in this report, those reported collections were significantly understated. As a result, amounts transferred for the benefit of the designated agencies were substantially less than intended by the Legislature.

### **A. Annual Estimate Requirement**

Senate Bill 477, passed in 1994, required the Office of Administration to prepare an annual estimate of state income tax revenues received from nonresident members of professional athletic teams and nonresident performers. For fiscal 1996 and for each subsequent fiscal year for a period of nine years, an amount equal to fifty percent of the estimated collections was required to be transferred to the Missouri arts council trust fund. Senate Bill 724, passed in 1998, extended the allocation of tax revenues to December 31, 2008, and increased the transfer to the Missouri Arts Council Trust Fund to sixty percent of the estimated collections for fiscal year 2000 and subsequent years. Other provisions of the 1998 law created allocations of ten percent of estimated income tax revenues received from nonresident members of professional athletic teams and nonresident performers, for fiscal years from 2000 to 2008, for the benefit of the Missouri Humanities Council Trust Fund, the Missouri State Library Networking Fund, the Missouri Public Television Broadcasting Corporation Special Fund, and the Missouri Department of Natural Resources Missouri Historic Preservation Revolving Fund.

Office of Administration employees we contacted said one estimate was completed in 1996 for revenues realized from the taxation of nonresident professional athletes and entertainers. We were told that no other estimates were prepared, and that no documentation for the 1996 estimate could be located. Transfers for years from 1997 through 2001 were based on the 1996 estimate as adjusted for an assumed rate of growth due to inflation and population change. Our review of professional athletic salaries indicated that salaries grew at a rate between ten and twenty percent per year, significantly greater than inflation and population change.

### **B. Athletes Residency**

When we compared the Office of Administration's (OA) estimates with Department of Revenue reports, and available external information and discussed the estimates with OA staff, we concluded the estimate did not include employees of Missouri professional athletic teams. OA staff confirmed their assumption that members of Missouri professional athletic teams were Missouri residents for tax purposes. Department of Revenue personnel said the same assumption was used when the Department provided information relating to collections. The estimate, according to Section 143.183, RSMO, is to include state income tax revenues collected from nonresident members of professional athletic teams and nonresident entertainers. No distinction is made for the location of the team.

Oversight contacted the major professional sports teams located in Missouri and obtained confirmation that a substantial majority of the athletes were nonresidents. Oversight estimates that taxes collected from nonresident athletes employed by Missouri athletic team would have approximated \$4.6 million in 1999, the most recent year for which data was available. Tax collections for other years would be of similar magnitude. These taxes would likely have been collected by the Department of Revenue but not considered in the computation of amounts transferred to the funds noted in part A above.

### **C. Reduction of Transfer Amounts**

We noted that the Office of Administration reduced the amounts transferred for FY 2002 without preparing a formal estimate; as discussed above, one estimate was prepared for 1996 and amounts for subsequent years were computed using an estimated growth percentage. When we contacted the Office of Administration regarding the 2002 estimate, we were told the 2002 transfers were based on the Department of Revenue's reported collections for 2001. As discussed in Comment 4, we noted problems with the Department of Revenue's tracking of tax returns filed by nonresident athletes and entertainers, and thus their reported collection amounts.

Oversight recommends the Office of Administration develop a methodology for preparing well-documented annual estimates of tax collections based on objective and verifiable data, and suggests specifically that nonresident athletes employed by Missouri teams be included in those annual estimates.

#### **Comment 2:**

**It appears transfers made by the Office of Administration were likely substantially less than taxes collected.**

Oversight was not provided detailed information by the Department of Revenue regarding Missouri taxes withheld from and paid by the various nonresident athletes and entertainers because of the scope limitation discussed in Comment 7. Oversight instead calculated an expected tax yield as follows:

#### **A. Professional Athletes**

Department of Revenue regulations provide a specific method for determining taxable income for professional athletes. According to 12 CSR 10-2.220, Missouri taxable income for a nonresident athlete is to be determined by dividing the total of all game, training camp, post-season, and travel days (duty days) spent in Missouri by the total of all such days the player spent with the team. Based on published schedules for these sports, Oversight determined the total number of duty days for the season and the minimum number of duty days that teams spent in the state during the year.

Oversight then calculated the expected tax yield for professional athletes based on published reports of player salaries for the major professional sports located in Missouri (baseball, football, and hockey) allocated by Missouri duty days. The most recent year for which payroll data was located for all three sports was tax year 1999. Oversight did not consider coaching and trainer salaries. Although not considered significant, they would cause a slight addition to our estimates. Oversight also excluded other sports from the computation due to inadequate data regarding salaries in other sports.

For teams located in Missouri, Oversight calculated tax revenues of \$4.6 million for tax year 1999, based on an effective tax rate of 6%, the number of duty days in the state, and the assumption that at least 80% of the team members are not Missouri residents. Oversight determined this percentage from discussions with representatives of the major sports teams located in the state. For visiting teams, Oversight calculated tax revenues of \$3.3 million for tax year 1999, based on an effective tax rate of 6%.

## **B. Professional Entertainers**

The Department of Revenue reported collection of \$2.1 million from entertainer withholdings and filings for tax year 2000. The total was \$0.8 million for tax year 1999 when few venues were able to withhold and remit taxes since contracts were already signed prior to the law taking effect. However, since the entertainer was primarily liable for taxes on their income, revenues from these nonresident entertainers should have been included in the estimate. Oversight developed an estimate of \$2.8 million per year from nonresident entertainers based on data obtained from the Missouri Arts Council and the Branson Chamber of Commerce.

## **C. Transfers Less than Required**

The Office of Administration indicated that they based the FY 2002 transfer appropriations on collections as reported by the Department of Revenue. Prior years transfers were based on an original estimate prepared in 1996 and updated

only for an annual inflationary factor. As shown on the chart in Chapter 2, Oversight believes the Office of Administration estimate substantially understates the revenues from this program and thus the required transfers.

Oversight recommends that OA develop a comprehensive estimate of revenues from nonresident athletes and entertainers, including all appropriate sources of revenue. Transfers should be based on these estimates as required by state law.

**Comment 3:**

**The Department of Revenue's tracking of income tax revenues from nonresident members of professional sports team and entertainers was inconsistent and incomplete.**

Revenue from nonresident professional athletes and entertainers is processed within the Department of Revenue's general systems for payroll tax withholding, and for individual and corporate income tax returns. Separate systems for this program have not been established. The Department of Revenue instead developed reporting routines to recover data regarding this program from overall Department of Revenue operations. Oversight noted a number of concerns in the way the Department of Revenue tracked and accounted for revenues from nonresident professional athletes and entertainers.

**A. Tracking Methods**

Department of Revenue (DOR) staff informed us they considered their tracking of payments within the withholding tax system to be accurate, but that they did not consider tracking of returns and payments by individual athletes and entertainers within the individual and corporate income tax systems to be feasible. They said tracking of actual taxes paid by an individual is based on that individual checking a box on the Missouri individual income tax form, and said they were unable to determine if taxpayers consistently checked the box on their returns. Additionally, DOR management told us their reporting of amounts paid by individuals on these marked returns depends on a DOR employee noticing the checkmark on the return and recording it in the DOR computer system when it is processed.

The fiscal note for Senate Bill 477, 1994, included no fiscal impact to the Department of Revenue. At that time, the

Department apparently did not foresee the need for computer programming related to these earmarked tax collections. The existing tracking system is subject to high risk of failure because of its reliance on individuals manually marking returns and DOR employees noting and recording the marked returns in DOR computer records. Further, it appears the current manual system is not really capable of automation.

Organizations such as entertainment venues and sports leagues provide athletes and entertainers with documentation of payments made to the athletes and entertainers, and related withholdings. Under federal and state law, copies of the documentation are provided each year to the Department of Revenue. Oversight assumes these documents could be tracked to allow the Department of Revenue to directly determine the actual taxes paid by athletes and entertainers when their tax returns are filed. The Department's failure to develop a workable method of tracking individual and corporate tax returns processed creates additional risk that incorrect and improper decisions will be made about the program. Oversight believes that software capability to allow direct tracking of income tax returns filed and taxes due and paid based on identified employment relationships could be developed, would provide more accurate results, and would eliminate the need to rely on manual check boxes on the tax return.

### **B. Consistency of Tracking Returns**

Department of Revenue (DOR) staff initially informed us that tracking of information on individual returns for athletes and entertainers had been discontinued recently. We were later told that the Department eliminated their tracking efforts due to concern about the reliability of their tracking system as noted in part A above. We were finally told that procedures had not changed, except that the DOR computer system report for calendar year 2000 individual tax returns filed in 2001 had not been prepared as of the end of our review.

After the end of the fieldwork for our review, DOR advised us that they had rechecked their records and determined that



approximately \$20 million in taxes for nonresident athletes and entertainers had been collected during the year that ended June 30, 2001. A report previously prepared by DOR for this review indicated total collections of \$4.6 million, while an economic consultant analyzed the same data and reported total collections of \$6.2 million. Oversight believes that the Department of Revenue should use the best methods available to it in determining and reporting results of its operations.

Oversight Recommends the Department of Revenue develop and use a reliable method of tracking actual taxes assessed and paid by professional athletes and entertainers. As an added benefit, this system could be used to verify that required tax returns were filed by athletes and entertainers.

**Comment 4:**

**Reported withholding from professional athletes' salaries by sports leagues was less than expected based on published salaries and Missouri tax rates.**

Our review of the Department of Revenue's reported withholdings from nonresident professional athletes indicated the reported withholdings are significantly less than amounts we computed at a withholding rate of six percent. Further, our review of the pro-forma agreement between the Department of Revenue and the leagues indicates that the Department provided a specific rate for the leagues rather than directing them to use Missouri withholding tables.

As noted in Comment 1, the most recent information available for professional athletes' salaries was for 1999. Oversight based its estimate of \$3.3 million in tax withholding for professional sports teams that visited the state in 1999 on published team salaries and a 6% expected withholding rate. Oversight's estimate did not include sports other than hockey, football, and baseball, and did not include coaching staff or trainers. Department of Revenue staff said "the majority" of withholding agreements between the Department and the leagues required a flat 6% rate. They also said that any agreements with a lower rate would be for sports with a lower salary structure and thus, lower expected tax liability. The 6% expected withholding rate is equal to the maximum Missouri individual income tax rate since published information indicates that these athletes' salaries would generally make them subject to tax

at that rate. Further, Oversight contact with an economic consultant confirmed that the effective tax rate for high-income taxpayers should be 6%.

Department of Revenue withholdings collected from professional sports leagues for athletes who visited Missouri were \$2.4 million for tax year 1999. This amount is only 71% of the \$3.3 million estimate. Thus, the effective withholding rate for the leagues was 71% of 6%, or 4.26%. The actual rate is expected to be approximately 4% since the Oversight estimate did not include all sports or all team personnel subject to the program. This information cannot be confirmed due to the withholding of information by the Department of Revenue, as discussed in Comment 7.

Oversight prepared the estimate of collections from sports teams that visited Missouri to provide a comparison consistent with the Department of Revenue's reported collections, since Department of Revenue management told us they assumed members of Missouri teams would be residents.

Oversight recommends the Department of Revenue revise all of the league withholding agreements to require a flat 6% rate or use of the standard Missouri withholding tables.

**Comment 5:**

**The Department of Revenue contractually released highly compensated professional athletes from filing income tax returns.**

The pro-forma agreement between the Department of Revenue and the leagues provided a release for all parties from unspecified current and prior year tax assessments. In addition, the agreement states that players need not file Missouri income tax returns if the players' only Missouri income is from the league. We noted that the preparation and filing of a personal or corporate tax return is the only method by which taxpayers would receive a refund of overpaid taxes, or pay any additional taxes due.

Since we noted in Comment 4 that the leagues' withholding rate appears to be significantly less than the expected tax rate, additional taxes would appear to be due in many cases. If additional taxes are actually due, this tax liability may never be collected since the agreement exempted players from the requirement to file tax returns. The combination

of these provisions in the agreements appears to provide highly compensated professional athletes with a discounted state income tax rate. Oversight is not aware of any other occupational group offered this sort of preference, and has not been able to identify any statutory authority for the Department of Revenue to offer discounted state income taxes.

Oversight recommends the Department of Revenue revise the league withholding agreements to require compliance with state law regarding individual tax return filing.

**Comment 6:**

**Implementation of  
Senate Bill 724 by State  
Fair**

Senate Bill 724 was passed by the Legislature, and became effective, in 1998. The act increased the percentage of income taxes on nonresident athletes and entertainers designated for the Missouri Arts Council to 60%, extended the earmarking through the year 2008, and designated the remaining 40% of estimated income tax revenue for the four other agencies.

Another new provision of this bill required any person or entity paying compensation to a nonresident entertainer to withhold and remit to the Department of Revenue two percent of the total compensation paid to the nonresident entertainer as a prepayment of tax. Department of Revenue managers said they advised entertainment venues of this new requirement in 1998, and prepared informative brochures for the venues to use in explaining the law. Because these venues commonly contract entertainers in advance, some venues were unable to comply promptly. As a result, reported collections from this withholding provision show a gradual increase starting in 1998.

The Oversight division surveyed state agencies and state-supported colleges and universities regarding the withholding requirement. The results of our survey indicated that most state-supported organizations achieved substantial compliance with this law in 1999. The State Fair reported that it began withholding and remitting prepaid taxes for its entertainment contractors in 2000. Oversight staff were informed by other sources that the

Department of Revenue strongly encouraged the State Fair to comply with the withholding requirement, although Oversight was unable to review these situations with the Department of Revenue. Department of Revenue staff declined to discuss specific compliance situations including the State Fair due to the scope limitation discussed in Comment 7 .

Oversight recommends the State Fair continue to withhold and remit prepayments of tax as required by state law.

**Comment 7:  
The Department of Revenue has imposed significant restrictions on the availability of tax and other data to the Oversight Division. Accordingly, no review or testing of actual data for Athletes and Entertainers Tax was performed.**

The Department of Revenue has imposed significant restrictions on the availability of tax and other data to the Oversight Division and other outside organizations. A review of relevant supporting information is considered necessary to provide assurance that procedures are operating as intended and reported program results are correct. Oversight's review was limited to an analysis of the Department of Revenue's compilation of tax collections reported for the program, review of the pro-forma contract and entertainer brochures, and discussions with Department of Revenue employees. Because no detailed testing or review could be done, Oversight can provide no assurance as to the accuracy or completeness of the Department of Revenue's reported information.

The Department has interpreted Section 32.057 RSMo to prohibit any disclosure to anyone outside the Department which might conceivably include information identifiable with an individual taxpayer. We noted, however, the statute allows the Department of Revenue to contract with outside agencies and provides exceptions for a series of circumstances. We also noted the Department of Revenue uses these exceptions to allow other agencies, including sports leagues, private collection agencies, computer consultants, and University of Missouri researchers, to access the confidential taxpayer information.

We requested access to copies of contracts with sports leagues, with taxpayer names, addresses, and identification numbers blacked out as provided by a Missouri Supreme Court decision. Based on its interpretation of Section 32.057 RSMo, the Department specifically denied Oversight staff access to the contracts. We were instead

provided a copy of a pro-forma contract for a sample sports league with names, dates, number of players and teams, and withholding rates deleted, and a set of informational brochures sent to entertainment venues, which the Department of Revenue had developed to explain the withholding law to entertainers. We were later provided access to photocopies of a few selected tax returns filed by professional athletes and entertainers. The returns were selected by DOR and had names and other identifying information blacked out.

We contacted other states and found that those states had processes in place to provide an independent review of their taxation systems. We also found that the United States General Accounting Office has access to federal tax return data, and some states even provided their audit agencies with access to federal tax return data to provide assurance that state tax law was properly administered. As a result of the Department of Revenue's practice of excluding agencies such as the Oversight Division and the State Auditor's Office from access to relevant data, a complete review of this program could not be conducted. Therefore, the Department of Revenue and the state of Missouri have lost the potential benefit of an independent review.

Oversight recommends consideration of modifications to the confidentiality statute to allow objective evaluations of Department of Revenue programs and procedures by independent professional staff with access to actual data.

## **Appendix 1 - Department of Revenue Response**

BOB HOLDEN  
GOVERNOR



CAROL RUSSELL FISCHER  
DIRECTOR OF REVENUE

MISSOURI DEPARTMENT OF REVENUE  
POST OFFICE BOX 311  
JEFFERSON CITY, MISSOURI 65105-0311  
PHONE: (573) 751-4450  
FAX: (573) 751-7150  
WEBSITE: [www.dor.state.mo.us](http://www.dor.state.mo.us)  
E-MAIL: [dormail@mail.dor.state.mo.us](mailto:dormail@mail.dor.state.mo.us)

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November 30, 2001

Ms. Jeanne Jarrett, CPA  
Committee on Legislative Research  
Oversight Division  
State Capitol Building, Room 132  
Jefferson City, MO 65101-6806

Dear Ms. Jarrett:

Following are the Department of Revenue's responses to the Oversight Division's draft comments concerning professional athletes and entertainers.

#### **Response to Comment 2**

The Department of Revenue agrees that it should report the total amount of Missouri income taxes withheld for non-resident athletes and entertainers to the Office of Administration. Comment 2 is correct that for past years, the Department of Revenue did not report the total amount of tax collected, and the appropriation was less than the tax collected. Specifically, the amount reported by the Department of Revenue to the Office of Administration included tax withheld for non-resident athletes employed by non-Missouri teams and for non-resident professional entertainers, but it did not include the tax withheld for non-resident athletes employed by Missouri teams. Withholding tax was collected for the non-resident athletes employed by Missouri teams and reported as General Revenue; however, the Department failed to include these amounts in the totals reported to the Office of Administration for non-resident athletes and entertainers.

The Department of Revenue will provide withholding tax totals for all non-resident athletes and non-resident professional entertainers to the Office of Administration. For FY 2001, this amount was \$19.1 million.

### **Response to Comment 3**

The department's fiscal note on Senate Bill 477, 1994, states: "The Division assumes that no reports will be required to be generated and furnished to the Office of Administration and that they will gather information from other sources in order to facilitate estimating the amount of income tax moneys derived from these groups . . . . If this assumption is incorrect and information must be collected and tabulated on these filers, additional resources would be necessary." At the time this fiscal note was filed, Oversight did not state this assumption was incorrect and did not recommend resources to develop reports. The department received no resources to implement a tracking system and will be unable to improve on the existing tracking system that is not required by law, without new resources.

### **Response to Comment 4**

Oversight did not provide the department with Comment 1 and did not provide specific information the department could use to determine the reasonableness of Oversight's estimate of \$3.3 million in expected tax withholding.

None of the agreements currently in effect are similar to the pro-forma agreement referenced in the report. The department has provided Oversight with a pro-forma agreement similar to the ones that are actually in effect, but that information was not taken into account in Oversight's report. Those agreements require the teams to withhold as required by Missouri law.

Oversight's assumption that the effective tax rate is 6 percent of the gross salary ignores the tax impact of statutory deductions from gross income to arrive at taxable income. One significant omission is charitable contributions, something many professional athletes are routinely publicly recognized for. Oversight should clarify with its economic consultant that the effective tax rate for high-income taxpayers should be 6 percent of taxable income, not gross income.

As a result of Oversight's inquiries, the department has reviewed a sample group of tax returns filed by non-resident professional athletes. This review revealed that the appropriate amount of tax is being withheld for non-resident athletes. In other words, the tax withheld was substantially the same as the athletes' actual Missouri tax liability.



### **Response to Comment 5**

The department did not release highly compensated professional athletes from filing income tax returns. As noted in Comment 4, Oversight bases this comment on an agreement that is not in effect with any league at this time. The agreement in question did not involve “highly compensated” individuals. More importantly, as noted above, testing of returns filed by players from various teams and professional sports leagues indicates that the amount being withheld is substantially accurate.

### **Response to Comment 7**

Under Section 32.057, RSMo, tax records received by the department are confidential. This statute prohibits the disclosure of all tax returns as well as any related information that would identify the taxpayer, except in limited circumstances. Any disclosure made in violation of this section constitutes a Class D felony.

As correctly noted in the draft report, there are some limited exceptions to the confidentiality statute. However, the report is incorrect in its assertion that individual income tax returns and other individually identifiable tax records are made available to “sports leagues,” or “University of Missouri researchers.” The department does not disclose information that would identify individual taxpayers to these groups. The department does have express statutory authority to contract with collection agencies, and some confidential tax information is disclosed to these contractors because it is necessary for their activities. In addition, the legislature has specifically authorized the department to disclose tax information to other executive branch agencies in limited circumstances, under Section 610.032, RSMo. Finally, if the department contracts with a vendor for computer services, it is possible the vendor would have access to confidential tax information if such access were necessary for the performance of the computer services. In each of these limited circumstances, however, the party receiving the information is bound by the same confidentiality standards as the department, and is not permitted to re-disclose the information.

The department recently reviewed the issue of whether individual tax returns could be made available to the State Auditor. Our research revealed that both the Attorney General and the Missouri Supreme Court have ruled that there is no legal authority for disclosing income tax records to the State Auditor. In addition, neither the income tax laws of Missouri nor the federal law authorize the State Auditor to have access to income

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tax returns and records. Under Section 32.057.4, RSMo, the auditor has no greater right to access Missouri income tax returns than specifically exists under the Missouri income tax law or federal law. Accordingly, the department is not authorized to disclose individual income tax records to the State Auditor. To do so, would violate the provisions of Section 32.057, RSMo.

The confidentiality of tax records is a personal privacy issue. We know that this is a serious concern of many Missouri citizens. Moreover, the department's interpretation of Section 32.057, RSMo represents longstanding policy. This policy has not varied despite changes in Directors of Revenue and administrations. The department respectfully submits that the subject of this report, i.e., whether the funds listed in Section 143.183, RSMo, are receiving adequate revenue under the law, can be fully addressed without broadening the exceptions to Section 32.057, RSMo to allow more disclosure of personal income tax information.

If you have any questions, please let me know.

Sincerely,

A handwritten signature in cursive script, reading "Carol Russell Fischer".

Carol Russell Fischer

CRF/jls

**Appendix Two -**  
**Evaluator's Comments on**  
**Department of Revenue Response**

## **Evaluator's Comments on Department of Revenue Response**

### **Comment 3**

Oversight assumes that administering the State of Missouri's taxation system, including collecting, recording, and reporting taxes, would be among the basic of functions of the Department of Revenue and funded in its core budget.

### **Comment 4**

The Department of Revenue's response to comment 4 creates a new and extremely troubling situation. Oversight received the pro-forma agreement from Department of Revenue management as an example of the agreement in place between the Department of Revenue and the various sports leagues. This pro-forma agreement was specifically referenced in a letter dated July 20, 2001 from the Department of Revenue. The first indication that this was not the case was the Department of Revenue's response to the report. Any change to a key piece of information at the end of a program evaluation is a serious matter. If a newer agreement had been in place which requires the employers to use the Missouri withholding tax tables, Oversight should have been provided that document rather than the pro-forma agreement. If a newer agreement has recently been implemented which requires the employers to use the Missouri withholding tax tables, the Department of Revenue's response should have so stated.

Oversight has confirmed and reconfirmed the applicable tax rate with its economic consultant. The Missouri Form MO-NRI for nonresidents does not provide for the allocation of charitable contributions to Missouri income by nonresidents. They are allocated to the taxpayer's home state income. Further, Missouri law provides for tax at a 6% rate for all taxable income over \$9,000. In order for a taxpayer to have a 4% effective tax rate on Missouri income, the taxable income could be no higher than \$11,250.

The selection of a sample of tax returns filed by nonresident athletes would not necessarily confirm the assertion that withholding was correct. The Department of Revenue has declined to release any information regarding filing compliance by nonresident athletes. Athletes who are overwithheld would file for a refund, but athletes who are underwithheld would have a balance due upon filing a return, and would have a significant incentive not to file.

### **Comment 5**

As we noted regarding Comment 4, Oversight relied on assertions and information provided by Department of Revenue management.

### **Comment 7**

As we noted regarding Comment 4, Oversight relied on assertions and information provided by Department of Revenue management. The proforma agreement we reviewed provides for information to be made available to the sports leagues. However, the Department of Revenue has now stated that document is not valid. We agree that personally identifiable information is not provided to University researchers; instead, the taxpayer identification number is replaced by a coded identifier.

Finally, we regret to note that the Department of Revenue's response does not include any indication of corrective action proposed as a result of this review.